

VZCZCXRO6447
PP RUEHDBU
DE RUEHKV #2286/01 2561005
ZNY CCCCC ZZH
P 131005Z SEP 07
FM AMEMBASSY KYIV
TO RUEHC/SECSTATE WASHDC PRIORITY 3721
INFO RUEHZG/NATO EU COLLECTIVE
RUCNCIS/CIS COLLECTIVE
RUEHLMC/MILLENNIUM CHALLENGE CORP WASHDC

C O N F I D E N T I A L SECTION 01 OF 03 KYIV 002286

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E.O. 12958: DECL: 09/13/2017

TAGS: [PGOV](#) [EPET](#) [PINR](#) [UP](#)
SUBJECT: UKRAINE: IUD'S TARUTA ON REGIONS, ELECTIONS, AND
GAS DEALS

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Classified By: Ambassador for reasons 1.4(b,d).

¶1. (C) Summary. In a marathon three-hour meeting, reclusive Industrial Union Donbas (IUD) owner Serhiy Taruta and his more politically-active partner Vitaliy Haiduk gave the Ambassador their views on the elections, Regions party leaders, and the current gas deal with Russia, especially their concerns over shady middleman RosUkrEnergo. Taruta has tried to stay out of politics and focus on running the business, while Haiduk has drifted between government positions and IUD. (Note. They were recently ranked 6 and 7 on Korrespondent's richest men in Ukraine issue, with about \$1.7 billion each. End note.) Both made their money in 1990s Donetsk, and Taruta and Regions oligarch Rinat Akhmetov were once close business allies. Even though IUD and Systems Capital Management have gone their separate ways, Taruta and Haiduk have insights into the Party of Regions's leadership that few others have. End summary.

Politics: Not My Cup of Tea

¶2. (C) During an August 6 meeting, Taruta told the Ambassador that he is not involved in politics, although it is hard to avoid it sometimes. He added that the June 1 amendments to the election law increased the mix of business and politics, what he termed "a very dangerous merger," and characterized the influence of money on changes in the country as substantial. He said that was the problem of having no political party culture. Some of the MPs currently in the Rada were of such low quality, he said, that if they were in another parliament, their parties would be discredited by now.

Donetsk Clan: Then and Now

¶3. (C) Taruta provided a detailed history of the Donetsk clan and the relations between key Regions figures. He said that he had worked for ten years as director of sales at the steel plant in Mariupol when Haiduk invited him to Donetsk city to get involved in a gas project stemming from the non-payment crisis with Central Asia and Russia in the mid-1990s. The end result of this partnership was IUD, which was involved in the gas trade for eight years -- at its peak, they made up to \$1 billion of gas/year in credits, equal to Donetsk's total gas consumption.

¶4. (C) According to Taruta, Akhmetov personally convinced President Kuchma to appoint Yanukovych governor of Donetsk in 1997. In those days, Akhmetov was very different -- he was totally private with no public persona, and was trying to find ways to deal with his "difficult past." At the time,

there was a unique relationship between business and government in Donetsk -- business funded regional and local government salaries, the government developed oblast infrastructure and economics, and they got good results.

Haiduk and Andriy Klyuyev were both working under Yanukovych as deputy governors. Then Klyuyev provoked a change in the relationship by making Yanukovych his business partner, so he would get preferences. Taruta did not know if they were still business partners, but said they have a special relationship.

¶ 15. (C) Taruta described Klyuyev as different from the others from Donetsk. He was in a different business, which was relatively well-run and honest. (Note. Klyuyev has interests in ball bearings and electricity distribution, whereas most Donetsk business made their money in metals and/or coal. End note.) Taruta thought Klyuyev was smart enough to implement reforms. Unfortunately, he had learned early that he could make money from holding a senior position, now he was abusing his office for self-enrichment. For example, according to Taruta, Klyuyev was smuggling huge amounts of chicken through a Special Economic Zone. Taruta thought Yanukovych might be getting a taste of the chicken smuggling as well, although he wasn't sure. Taruta said that Klyuyev knows that the RosUkrEnergo deal was bad -- that's why he has a conflict with Energy Minister Boyko. If Boyko wins and RUE stays in the gas business, it means that Yanukovych now depends more on Boyko, financially and politically. Haiduk said Klyuyev sold his energy business to Akhmetov.

¶ 16. (C) Taruta believed that Akhmetov and Kolesnikov might have a different mindset -- they were younger and therefore, they lacked the experience of working in Soviet production. Regardless of whether they are interested in EU accession, in Taruta's view, both want liberal economic policies. They would have liked to do business in the Yeltsin-era Russia, but they can't operate in today's Russia, so they have no interest in a pro-Russian policy.

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¶ 17. (C) In contrast, Azarov is from the generation of soviet-era administrators and red directors, like Kuchma. Taruta said that Azarov and his generation don't know how to formulate economic policies that are different from what they grew up with. They want to concentrate resources and divide them up among themselves. Yanukovych is also from this latter system - a Communist Party apparatchik who prefers centralized authority. He knows if he gives a little here, he can take a little there. Azarov fulfills important functions well -- he knows how to create an effective government machine, first the State Tax Authority, and now the general fiscal system. How he uses his government machine is another question, but he gets the job done. In summing up, Taruta dismissed the whole Donetsk-Regions group, saying "they're all looters."

2006 Gas Deal: Bad News for Ukraine

¶ 18. (C) Taruta said that the 2006 gas deal that the Yushchenko administration signed with Moscow is one of few issues that really riles him up because it was so absolutely contrary to Ukraine's interests and criminal in nature. Taruta said Ukraine was losing \$3 billion/year from the 2006 gas deal. Yushchenko had inherited the bad gas situation -- Kuchma created it after relations with West soured and he turned to Russia, but Yushchenko has not been able to fix it. Taruta thought Yanukovych was not interested in a transparent gas deal.

¶ 19. (SBU) Note. On January 4, 2006, Ukraine's state oil and gas company NaftoHaz signed a deal with Gazprom in the aftermath of Russia's brief shut-off of gas supplies. The deal raised Ukraine's wholesale price from \$50/billion cubic meters (bcm) to \$95 for 2006, fixed Ukrainian gas transit

rates for five years, and made RosUkrEnergo (ostensibly owned half by Gazprom and half by two Ukrainians, Dmytro Firtash and Ivan Firsun) Ukraine's counter-party. In addition, the deal created UkrHazEnergo, a joint venture between RUE and NaftoHaz, to market imported gas to industrial users. The deal remains in effect although the price of gas rose to \$130 in 2007. End note.

¶10. (C) There were three reasons, Taruta argued, why the deal was still in force. To begin with, the agreement was upheld in court -- IUD went to court in 2006 to argue that gas deal did not meet international standards, but lost. In addition, although Russia has no alternative transit capacity for at least six to eight more years, Moscow scared the Ukrainian population, government, and Yushchenko himself by showing that it could cut supplies for a long time. In reality, according to Taruta, it wouldn't have been possible to shut off the supply for more than a day. Finally, Russia has no alternative buyer other than Europe so the gas will continue to flow west through Ukraine.

¶11. (C) Taruta believed a pro-Ukrainian, pro-European government in Kyiv could resolve gas problem at the presidential level by finding a compromise between \$50/tcm and \$130/tcm, back somewhere around the \$90-\$95/tcm that Ukraine paid in 2006. Then the price could rise gradually over five to six years, finally reaching European levels minus the difference in transit costs. If President needed leverage in new negotiations with Moscow, he should take the case to a Western court and argue that the Russians abrogated a binding contract in 2006 by insisting on the new deal. (Comment: Several, including former PM Tymoshenko, have argued Ukraine should take the Russians to court and re-instate the pre-2006 pricing. However, others in the GOU at the time, who had access to the details of the agreements, argued to us that Ukraine's chances in court would not be good. End Comment.)

¶12. (C) In the interim, in Taruta's view, industries should switch to energy-saving technologies. For example, Ukraine could save 6 bcm of internal reserves in its gas transit system by replacing gas-fired compressors with electric ones.

The metals sector alone, Taruta argued, could save 2 bcm a year; for example, Alchevsk steel plant moved away from gas and electricity consumption in the last two years, its production is greater than Kryvoryzhstal.

¶13. (C) Taruta said he had shared his views with Lyovochkin, but the PM's Chief of Staff replied that if they didn't steal, someone else will, so why bother to fix the problem. Taruta thought every government was worse than the last one in this regard -- before, at least Ministers were scared of being punished, now they are confident in their impunity.

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RUE is Problem that No one Wants to Tackle

¶14. (C) Taruta said that everyone knows who is behind shady has middleman RosUkrEnergo (RUE) and that there was blame on both sides. On the Prime Minister's team, PM Chief of Staff Serhiy Lyovochkin managed the RUE deal for the Ukrainian government, while Energy Minister Yuiry Boyko was the point of contact for Moscow. On the President's side, Taruta believed that Yushchenko had helped with the deal, but was not personally corrupt; however, his brother Petro and adviser Oleksandr Tretyakov were. In addition, both he and Haiduk had heard Firtash was now meeting regularly with Yushchenko. Haiduk chimed in that Deputy Prime Minister Medvedev runs the RUE deal from the Russian side, making him the Kremlin's link to Yanukovych.

¶15. (C) In response to the Ambassador's question of who could tackle RUE, Taruta was very complimentary of Tymoshenko as the only politician who might be able to do so. At least she

had tried when she was PM. Haiduk had tried when he was running the NSDC, but got sidetracked by other issues. At heart, Yushchenko wants a new gas deal and might be able to do so if he had a new PM to work with. However, such an effort would face resistance. Big enterprises know gas prices will go up, but some don't have the money or understanding to change technology. In addition, any rise in household gas prices is politically sensitive and anyone who wants to run for president in 2009 knows that he or she can not be tagged as the person who increased gas prices.

¶16. (C) Haiduk added that he thought Yushchenko will not try to tackle RUE. He had been in two bilateral meetings between Yushchenko and Putin, and Yushchenko never raised it. In addition, the Presidential Secretariat is out of the game right now and no one in Russia will talk to NSDC Secretary Plyushch. Haiduk also warned that Firtash may change his scheme again soon anyway and find a new agent for gas deals.

Haiduk's Political Predictions

¶17. (C) After Taruta departed for a press conference, Haiduk offered his own thoughts on the current political situation. Regions will do well in the September 30 elections, and Tymoshenko will not get enough votes on her own to form the majority. He thought Our Ukraine was not aiming to increase its support in the center and east, just trying to get back votes they lost to Tymoshenko in 2006, with the help of foreign consultants.

¶18. (C) Haiduk said that he believed that if Tymoshenko and OU got enough seats, they would form the majority. Tymoshenko would become PM in exchange for backing Yushchenko in the 2009 presidential election. If that arrangement failed, Yushchenko would try a coalition with Regions, but it would not work out well for the President. A broad coalition would not help Yushchenko's standing in the east, but it would hurt him in the west, and he would lose to Tymoshenko in 2009. In Haiduk's view, there was no good combination of political forces for the country. A broad coalition was nonsense because polarization in politics between the east and west is too strong.

What the Partners Are Up To

¶19. (C) Haiduk and Taruta said they had reached the stage where they are not involved in day-to-day management of IUD, which frees them to work on other projects. Haiduk said he had bought into a new institute of international management in order to give MBAs to Ukrainians. He also wanted to get involved in the health care industry. Taruta said IUD just bought shares in a steel plant in the U.S. (Note: As part of the deal, IUD will supply steel billets to the U.S. mill.) He also mentioned that IUD is part-owner of the new Hyatt in Kyiv, into which they had invested \$80 million.

¶20. (U) Visit Embassy Kyiv's classified website:
www.state.sgov.gov/p/eur/kiev.

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